No. 98-418

Supreme Court, U.S.
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In The

Supreme Court of the United States

October Term, 1998

WYOMING DEPARTMENT OF TRANSPORTATION,

Petitioner,

v.

BEVERLY A. STRAIGHT,

Respondent.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Tenth Circuit

BRIEF FOR THE STATES OF NEW MEXICO, ALASKA, ARKANSAS, CALIFORNIA, CONNECTICUT, FLORIDA, GEORGIA, HAWAII, KANSAS, MICHIGAN, MONTANA, NEBRASKA, OHIO, OREGON, UTAH, THE COMMONWEALTH OF MASSACHUSETTS, THE COMMONWEALTH OF PENNSYLVANIA, AND THE COMMONWEALTH OF VIRGINIA AS *AMICI CURIAE*

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INTEREST OF *AMICI CURIAE*

In the last year, over 1.4 million bankruptcy petitions were filed in the United States by individuals and businesses that collectively owe many tens of millions of dollars in taxes and other debts to the States. That number has risen dramatically over the last few years and may continue to rise. Once a bankruptcy petition is filed, filing a proof of claim in bankruptcy court is often the only mechanism available to the state for obtaining even partial payment of the debt. Annually, state governmental entities file hundreds of thousands of proofs of claim in bankruptcy court. Indeed, in many cases, States are obligated by other federal laws to file claims in bankruptcy cases in order to participate in programs of benefit to their citizens.

The Bankruptcy Code, 11 U.S.C. section 101 *et seq.*, purports to "abrogate" "sovereign immunity" with respect to most bankruptcy proceedings, 11 U.S.C. 106(a), and further provides that a "governmental unit" (which includes a state) is "deemed to have waived" sovereign immunity under certain circumstances, 11 U.S.C. 106(b). The Tenth Circuit's opinion below concluded that, pursuant to those provisions, a state that filed any claim in a case relating to the debtor's business waived its immunity with respect to *any* claim filed against the state by the debtor that related in any way to the debtor's business, without limitation in nature or amount. *In re Straight*, 143 F.3d 1387 (10th Cir. 1998).

The *amici* States have a vital interest in this case, because the decision below significantly, unfairly and erroneously vitiates the States' constitutional Eleventh

Amendment immunity through the Tenth Circuit's employment of an artificial notion of "waiver," which is without any meaningful limits. The decision below significantly erodes the protection accorded to the States in the Eleventh Amendment of the Constitution whenever any state agency files any claim in bankruptcy court. It forces the States to either forego all contact with the bankruptcy system or surrender their constitutionally protected immunity with respect to matters which they have not voluntarily submitted for resolution by the federal courts. This is a choice that the Constitution does not require the States to make.

SUMMARY OF ARGUMENT

The court below determined that a state could be sued for monetary damages in bankruptcy court, reasoning that, because state agencies had filed claims for pre-bankruptcy taxes, the state was "deemed," pursuant to Section 106(b), to have waived its constitutional immunity from a cause of action arising from activities of its transportation department during the bankruptcy case. The court below ruled that this statutorily "deemed waiver" was valid. In addition to the award of attorneys fees and costs, the decision also left open the ability of the debtor to pursue its suit for further damages of $250,000 against the state in a related pending lawsuit.

To the extent the decision below rests on the common law decisions regarding waiver of sovereign immunity in bankruptcy, the decision directly conflicts with *Gardner v. New Jersey*, 329 U.S. 565 (1947), *In re Friendship Medical*

Center, Ltd., 710 F.2d 1297 (7th Cir. 1983) and *Ohio v. Madeline Marie Nursing Homes #1 and #2*, 694 F.2d 449 (6th Cir. 1982). Those cases held that a state waives immunity in bankruptcy court only to the extent necessary to determine or challenge the allowance of the state's claim. More broadly, the decision conflicts with numerous decisions in other areas of the law which utilize the same limited standard for waivers of immunity. *See U.S. v. Shaw*, 309 U.S. 495, 504 (1940) (by filing a claim in a probate proceeding, the United States only surrendered its immunity to the extent necessary to defeat the United States' claim); *U.S. v. Forma*, 42 F.3d 759, 764-65 (2d Cir. 1994) (the filing of a law suit by the Internal Revenue Service does not create jurisdiction to consider permissive counterclaims against the Service or to enter affirmative relief on any counterclaim).

To the extent the decision below rests on Congressional authority to control the scope of the state's Eleventh Amendment immunity, the decision directly conflicts with *In re Creative Goldsmiths of Washington, D.C., Inc.*, 119 F.3d 1140, 1147 (4th Cir. 1997), and cannot be reconciled with *Seminole Tribe of Florida v. Florida*, ___ U.S. ___, 116 S.Ct 1114 (1996). In *Seminole*, this Court ruled that "the background principle of state sovereign immunity embodied in the Eleventh Amendment is not so ephemeral as to dissipate when the subject of the suit is an area . . . that is under the exclusive control of the Federal Government." *Id.* at 1131. The Court further noted that it "never has awarded relief against a State under [the bankruptcy] scheme[ ]." *Id.* 1132 n.16.

Pursuant to the reasoning of *Seminole*, the Fourth Circuit has ruled that the deemed waiver provision, Section 106(b), is unconstitutional, in that it simply represents abrogation under a different name. *In re Creative Goldsmiths of Washington, D.C., Inc.*, 119 F.3d 1140, 1147 (4th Cir. 1997). Contrary to the Fourth Circuit, the Tenth Circuit's decision finds that Section 106(b) is constitutional based on a fundamental misreading of this Court's previous holding in *Gardner v. New Jersey*, 329 U.S. 565 (1947). This error must be corrected in order to ensure that the protections of the Eleventh Amendment are not eliminated by application of a waiver exception so broad that it swallows up the rule of immunity.

ARGUMENT

The petitioner's transportation department decertified the debtor from her eligibility to participate in a minority contractor program after she filed for bankruptcy. The bankruptcy court found this action violated the Code's automatic stay, 11 U.S.C. 362(a), and antidiscrimination provisions, 11 U.S.C. 525. The petitioner was ordered to reinstate the debtor's certification, and has done so. The petitioner does not contest those determinations here,[1] nor does the petitioner contest the obligation of the state to comply with the automatic stay or

[1] The state did not believe that it had violated the bankruptcy laws, arguing that its actions were actually motivated by bonding and financial responsibility concerns, which would be appropriate bases upon which to exercise its police and regulatory powers. *See, e.g., Duffey v. Dollison*, 734 F.2d 265 (6th Cir. 1984) (although state may not condition

with other bankruptcy laws. The only issue before the Court is the power of the federal bankruptcy courts to order affirmative monetary relief against a state agency on the basis that a different state agency "waived" the entire state's Eleventh Amendment immunity by submitting a claim to the bankruptcy court.

(a) Sovereign Immunity Prior to the Bankruptcy Reform Act of 1978

Prior to the Bankruptcy Reform Act of 1978, the federal government had not attempted to "abrogate" sovereign immunity or "deem" a waiver of state sovereign immunity in the bankruptcy courts. Since 1978, Congress has attempted to legislate the extent to which a state may be subjected to bankruptcy court orders, including those for monetary relief.[2] In *Seminole Tribe of Florida v. Florida,*

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renewal of driver's license upon payment of a discharged debt, the state may require a driver, who had failed to pay a judgment arising from an automobile accident, to comply with non-discriminatory financial responsibility laws which require either a three year insurance policy or a surety bond); *In re Synergy Dev. Corp.*, 140 B.R. 958 (Bankr. S.D.N.Y. 1992) (state could require Chapter 11 debtor health club to post a $50,000 bond, which was required of all health clubs in New York State). The petitioner is no longer contesting the bankruptcy court's conclusion. The merits of the action, however, have no bearing on whether the Eleventh Amendment applies.

[2] The first effort was deemed inadequate in *Hoffman* v. *Connecticut Dep't of Income Maintenance*, 492 U.S. 96 (1989) and *U.S. v. Nordic Village, Inc.*, 503 U.S. 30 (1992). Current language, adopted in 1994, was a Congressional effort to respond to the Court's holding that the original language was not a clear and unequivocal abrogation of immunity.

___ U.S. ___, 116 S. Ct. 1114 (1996), this Court ruled that Congress cannot constitutionally abrogate a state's Eleventh Amendment sovereign immunity through legislation enacted pursuant to Article I of the Constitution. The net result of the *Seminole* opinion, therefore, was to substantially reestablish the common law rules regarding the extent to which a state waives its immunity by participating in a bankruptcy. Those rules were well settled by an essentially unanimous line of authority under the Bankruptcy Act of 1898.

The decision below rests on the belief that Section 106(b) merely codifies (or indeed narrows) the common law standard of waiver that was in effect under the Bankruptcy Act. But this conclusion does not withstand analysis. Under the common law, the scope of waiver in bankruptcy occasioned by the filing of a proof of claim was the same as in non-bankruptcy proceedings. When the government brings an action in any other court, it is uniformly recognized that the government waives its immunity only with respect to recoupment of compulsory counterclaims that allow the defendant to diminish the amount claimed by the government. The government does not waive immunity for *any* affirmative relief, even relief stemming from compulsory counterclaims. *See U.S. v. Forma*, 42 F.3d 759, 764-65 (2d Cir. 1994) (collecting cases) ("Whatever the explanation, it has long been absolutely clear that the exception does not permit any affirmative recovery against the [government] on a counterclaim that lacks an independent jurisdictional basis.").

When governmental creditors filed claims in cases decided under the Bankruptcy Act, virtually all courts of appeals adopted the same rationale. *See, e.g, In re Friendship Medical Center, Ltd.*, 710 F.2d 1297, 1300 (7th Cir. 1983) (state only waives its sovereign immunity by filing a claim to the extent necessary to determine the merits of that claim; no affirmative recovery is available); *Ohio v. Madeline Marie Nursing Homes #1 and #2*, 694 F.2d 449, 461-62 (6th Cir. 1982) (same); *Danning v. United States*, 259 F.2d 305, 310 (9th Cir. 1958), *cert. denied*, 359 U.S. 911 (1959) (same result with respect to federal government); *In re Oxford Marketing, Ltd.*, 444 F.Supp. 399, 404-05 (N.D. Ill. 1978) (same). *See also In re Monongahela Rye Liquors, Inc.*, 141 F.2d 864, 868-69 (3rd. Cir. 1944) (although bankruptcy court has power to determine state's tax claim, it has neither jurisdiction to set off the tax against an unrelated debt nor to condition the payment of the tax claim upon the state's payment of an unrelated obligation). *See generally*, Jenkins, *Jurisdiction of the Bankruptcy Court to Deal with Claims of the Sovereigns, Objections to Such Claims and Counterclaims Against the Sovereign*, Journal of the National Conference of Referees in Bankruptcy 104 (1969).

(b) The Opinion Below

The court below determined that it did not have to reach the issue of whether Section 106(a), which contains an expansive abrogation of sovereign immunity, is constitutional in light of *Seminole Tribe of Florida v. Florida*, ___ U.S. ___, 116 S.Ct. 1114 (1996). Instead, the Tenth Circuit held that the bankruptcy court's judgment could be viewed as being issued pursuant to Section 106(b), which

deals with the extent to which the government is deemed to have waived its immunity with respect to compulsory counterclaims by filing a proof of claim in the bankruptcy case. The court concluded that Section 106(b) is constitutional, based on a conclusory and overly broad reading of *Gardner v. New Jersey*, 329 U.S. 565 (1947).

Gardner held that a state which files a claim submits to the bankruptcy court's power to consider the merits of that claim. According to the Tenth Circuit, Section 106(b) does no more than codify (and indeed limit) the *Gardner* holding. "This enactment codifies the *Gardner* rule . . . but narrows its applicability to permit the debtor to proceed only against claims asserted by the state that arose out of the same transaction or occurrence as the claim previously filed by the state in the bankruptcy court." 143 F.3d at 1390. The court essentially repeated this analysis later in the opinion, when it stated that section "106(b) does not pretend to abrogate a state's immunity, it merely codifies an existing equitable circumstance under which a state can choose to preserve its immunity by not participating in a bankruptcy proceeding or to partially waive that immunity by filing a claim. . . . Thus, section 106(b) follows the lead already established by the Supreme Court in *Gardner v. New Jersey.*" 143 F.3d at 1392.

The problem here is that the Tenth Circuit's view of *Gardner* is incorrect. Indeed, to the extent *Gardner* supports any rule on waivers regarding counterclaims, it is consistent with the common law view. There were no counterclaims of *any* nature in *Gardner*, a fact which the Court acknowledged as supporting the bankruptcy court's jurisdiction over the proceeding. The only issue in that case was whether the bankruptcy court was barred,

on Eleventh Amendment grounds, from hearing the trustee's objection to the state's claim. In fact, other courts of appeals have construed *Gardner* as implicitly limiting the ability to obtain affirmative relief against a government that files a proof of claim.

A persuasive analysis of *Gardner* is presented in *In re Friendship Medical Center, supra,* 710 F.2d at 1300-01:

> The [*Gardner*] Court held that where the state had filed the claim and where no one was seeking money from the state, there was no sovereign immunity problem. "If the claimant is a State, the procedure of proof and allowance is not transmuted into a suit against the State because the court entertains objections to the claim. The State is seeking something from the debtor. No judgment is sought against the State." *Id.* at 573-74. The Court concluded that the immunity is waived to the extent necessary to adjudicate the claim made by the state. "When the State becomes the actor and files a claim against the fund, it waives any immunity which it otherwise might have had respecting the adjudication of the claim." *Id.* at 574.
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> . . . .
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> As noted, *Gardner* . . . establish[es] that the limited waiver of sovereign immunity created by the filing of the claim extends only so far as necessary to adjudicate that claim, such as considering the objection of other parties to the claim.

Another court of appeals reached the same result with little discussion:

> [W]e are bound by a long line of cases to hold that an affirmative judgment against the [government] cannot be entered on a counterclaim without specific statutory authorization for affirmative relief against the government on the counterclaim as such. [citations omitted]. This does not mean that . . . the government's claim may not be contested, *Gardner v. New Jersey*, 329 U.S. 565 (1947).

Danning v. U.S., 259 F.2d 305, 309 (9th Cir. 1958).

The court below recognized that this Court's decision in *Seminole Tribe of Florida v. Florida*, ___ U.S. ___, 116 S.Ct. 1114, 1124 (1996) requires that there be a "valid exercise of power" before Congress can abrogate Eleventh Amendment immunity. 143 F.3d at 1392. The Tenth Circuit concluded, however, that section "106(b) does not pretend to abrogate a state's immunity, it merely codifies an existing equitable circumstance under which a state can . . . partially waive that immunity by filing a claim." *Id.* The court erred, though, by failing to recognize the extent to which Section 106(b) exceeds the common law waiver inherent in the voluntary filing of an action by the state in federal court.

Section 106(b) provides that a "governmental unit that has filed a proof of claim in the case is deemed to have waived sovereign immunity with respect to a claim against such governmental unit that is property of the estate and that arose out of the same transaction or occurrence out of which the claim of such governmental unit arose." This language fails to incorporate the "no affirmative relief" limitation on recovery from mandatory

counterclaims, thus expanding the recognition of waiver provided by the common law.[3] It is obvious that a "deemed waiver" can be an involuntary elimination of immunity under a different label. *See In re Creative Goldsmiths of Washington, D.C., Inc.*, 119 F.3d 1140, 1147 (4th Cir. 1997) (ruling that the waiver must be an *actual* waiver, that Congress has no authority to "deem" a waiver which did not occur, and that " 'constructive consent is not a doctrine commonly associated with the surrender of constitutional rights, and we see no place for it here.' " (quoting *Edelman v. Jordan*, 415 U.S. 651, 673 (1974)). The Tenth Circuit thought that the Fourth Circuit missed the point because Section 106(b) merely "follows the lead already established by the Supreme Court in *Gardner v. New Jersey*." 143 F.3d at 1392. However, Section 106(b) cannot be derived from *Gardner*. Accordingly, the Tenth Circuit is left without support for its conclusion that Section 106(b) is constitutional.

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[3] Some courts such as the Tenth Circuit in this case, and the Eleventh Circuit in *In re Burke*, 146 F.3d 1313, 1317, fn.8 (11th Cir. 1998), have indicated that they believe Section 106(b) codifies the common law of waiver. It should be clear, though, from the cases cited above, that Section 106(b) is actually an expansion of the waiver recognized at common law. *See also In re Koehler*, 204 B.R. 210 (Bankr. D. Minn. 1997) (noting the overbreadth of Section 106(b) and allowing a recoupment claim against the government only up to the amount of government's claim against the debtor). This broad reading of the intended scope of Section 106(b) is supported by the legislative history of its predecessor – Section 106(a) of the Bankruptcy Reform Act of 1978. "The counterclaim by the estate against the governmental unit is without limit." *House Report No.* 95-595, *95th Cong., 1st Sess.* 317 (1977).

The petitioner persuasively argues that the lawsuit by the debtor below, which arises from post-bankruptcy conduct of the state transportation department, cannot be accurately characterized as a compulsory counterclaim to the other state agencies' tax claims.[4] The debtor's lawsuit does not appear to fall within the scope of Section 106(b). To the extent the Court agrees with the petitioner on this point, the respondent may seek to save the result below under the notion that the constitutional analysis of *Gardner* supports the disposition below, whether the lawsuit be characterized as a permissive or compulsory counterclaim. As established above, the cases decided under the Bankruptcy Act certainly never understood *Gardner* to stand for the novel formulation of waiver of sovereign immunity that the Tenth Circuit espouses below. While Congress may have tried to statutorily "deem" a waiver

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[4] The *amici* States concur in the statutory analysis by the petitioner with respect to the meaning to be accorded to the phrase "same transaction or occurrence" in Section 106(b) and the ambiguity of the term "governmental unit" as used in that section. As further support for the split of authority cited by the petitioner with respect to the "same transaction or occurrence" language, *see In re Malinowski*, 1998 WL 484598 (2nd Cir. 8/19/98) (agreeing with *In re University Medical Ctr.*, 973 F.2d 1065, 1081 (3rd Cir. 1992) that same transaction and occurrence means " 'both debts . . . arise out of a single integrated transaction so that it would be inequitable for [a party] to enjoy the benefits of that transaction without also meeting its obligations.' "). Moreover, if it is appropriate to strictly limit the "same transaction and occurrence" language when the state seeks to rely on it to recoup payments it has made, surely the same phrase should be given an equally limited interpretation when a private party seeks to rely thereon to deprive a state of its constitutional immunity.

of immunity from affirmative monetary relief, the reasoning of *Seminole* and *Creative Goldsmiths* makes clear that Congress simply does not have the constitutional power to do so.

The *amici* States are deeply concerned by the decision below because it circumvents the States' constitutional Eleventh Amendment immunity and this Court's decision in *Seminole* through the use of a distorted reading of this Court's earlier decision in *Gardner.* The court below has read *Gardner* and Section 106(b) in ways that would render the States' Eleventh Amendment immunity a meaningless abstraction in bankruptcy so long as any government agency files any claim. The combination of its sweeping interpretations of *Gardner*, the definition of a "governmental unit" and the definition of the "same transaction or occurrence," could enable unlimited monetary recovery by the debtor against the state, so long as any of its agencies files any claim.

While the rule announced by the court below is alarming even if the state were always free to choose whether to file a given claim, the effect is even more disconcerting considering that federal law generally *requires* States to file claims in certain instances, such as with student loans.[5] Under the Tenth Circuit's holding,

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[5] 34 C.F.R. 674.49(b) Proof of claim. "The institution shall file a proof of claim in the bankruptcy proceeding, unless, in the case of a proceeding under chapter 7 of the Bankruptcy Code, the notice of meeting of creditors states that the borrower has no assets." One court even reached the absurd result of holding that this federal regulation constituted a valid waiver on behalf of the state, because the state enacted a statute which permitted

such a required claim could potentially open up the state's treasury to any action of the debtor. Surrendering the state's immunity from any lawsuits by borrowers who file for bankruptcy should not be the price for participating with Congress in the student loan program. The Court should reverse the opinion below and restore the status of the law to the situation which existed for the first 180 years of this nation's history.

CONCLUSION

For all of the foregoing reasons, *amici* States respectfully request that the Court grant certiorari in this case.

Respectfully submitted,

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it to abide by federal regulations. *In re Innes*, 207 B.R. 953 (Bankr. D. Kan. 1997).